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**Perspective**

***OECD Steel Doldrums: Serving the Soviet Interest (U)***

Despite some industry shakeout in recent years, OECD steel producers as a group will have massive excess capacity for the foreseeable future. Economic activity in the mature economies is shifting away from steel intensive activities, while growing steel self-sufficiency among the less developed countries is weakening export markets. As a result, developed country steel industries probably will not regain healthy rates of profitability until at least the end of the decade.

West European governments, in particular, have provided substantial assistance to financially distressed steel companies and instituted a number of programs to ease the impact of reduced employment. Subsidies and low export prices have evoked a strong response from the US steel community but naturally are welcomed by the cash short and steel hungry Soviets.

Except for the United States, the USSR—with \$3.5 billion of steel imports in 1981—is the largest single market for West European and Japanese steel and will continue to be so for at least several more years. Moscow continues to have problems in adding to capacity for high-quality steel and specialized steel products such as large-diameter pipe. We expect Soviet imports of these products to total \$17-20 billion in 1981-85. In addition, it is likely to fall considerably short of the 1985 production goals for other steel products.

Moscow is taking advantage of the current buyer's market for steel to minimize import costs. It is reaping substantial savings from lower steel prices, made possible in part by subsidies to producers. In addition, the Soviets continue to receive long-term, low-interest credits for imported large-diameter pipe, and they are pressing—in some cases successfully—for subsidized credits for nontubular steel. We estimate that total hard currency savings from these factors could amount to several billion dollars in 1981-85, particularly if market interest rates remain high. With the prices of gold and oil depressed, Moscow is anxious to limit hard currency cash outflows, preferring to push them forward to a time when prices for its exports may be stronger. Credit extensions allow the Soviets this alternative, and interest rate subsidies substantially reduce its cost.

The West Europeans will continue to resist attempts to curb competition for Soviet business. They have longstanding trade relations with the USSR and are committed to maintaining the viability of their respective steel sectors. A

US Government decision to impose countervailing duties on EC steel sales to the United States would worsen the situation for West European producers and stiffen the resolve of EC governments to resist any proposals to restrict the terms of steel sales to the Soviet Union. The angry reaction to the US moves to stop or delay the Siberia-to-Western Europe gas pipeline stems in part from their impact on steel sales.

*This article is Confidential.*

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## OECD Steel: Outlook Still Poor (U)

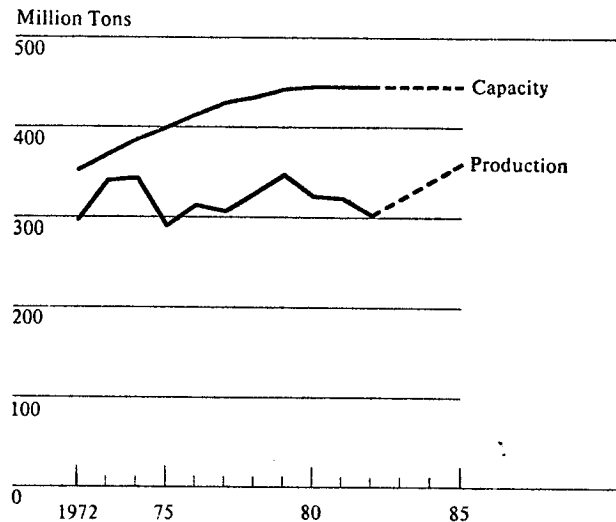
The OECD steel producers are confronted by a third straight year of declining production. Moreover, the industry will face excess capacity, low prices, and poor profits even at the peak of the next business cycle. While the Japanese industry will remain relatively strong, EC steel makers will continue to need considerable government support. Stiff competition on the world export market will persist, and US firms will remain vulnerable to cheap imports. Consequently, steel trade issues are likely to roil US-EC relations for the foreseeable future as the Europeans remain open to dumping charges. As an importer, the USSR will benefit from the bargain prices associated with excess capacity. (C)

### Weak Outlook for 1982

Crude steel production in the OECD probably will not exceed 365 million tons this year, down from 389 million in 1981. Long-term structural problems, which have depressed the steel market for the past seven years, and the current economic slowdown will account for much of the decline. In addition, the sharp drop in oil exploration has cut demand for tubular goods, one of the few bright spots in last year's steel market. (C)

Steel production in the United States is being hit the hardest and will account for most of the decline in OECD output. US producer shipments during the first six months were down 30 percent compared with last year, and the industry is operating at less than 50 percent of capacity. The US industry will be helped only slightly by the decline in imports that can be expected from the provisional levying of countervailing duties on subsidized steel

### OECD: Rolled Steel Capacity and Production



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from the European Community, Brazil, and South Africa. Reduced imports to the United States, however, will add to the problems of the steel exporting countries. (C)

In the European Community, steel production will drop in the third quarter after holding its own during the first half of the year. New orders fell substantially after March, and the EC Commission sharply cut July-September production quotas. Japanese steel output has been running well ahead of last year's level, but the industry now believes it will end 1982 with production only slightly higher than in 1981. Increasing concern over domestic

economic prospects, the poor export outlook, and rising steel imports account for the industry's pessimism. Output in other countries of the OECD is running at about last year's level. (C)

### Price Trends Are Mixed

Steel price trends are mixed but generally weak. OECD steel producers enjoy varying degrees of insulation in their domestic markets, but export sales are exposed to fierce competition. Thus export prices have been forced down 5 to 10 percent since the beginning of the year. (C)

US producers have increased some posted prices, but severe discounting continues and effective prices have changed little over the past year or so. In the European Community, there is doubt that the steel companies will be able to stick with their latest round of price hikes. Tokyo is allowing Japanese steel producers, who carefully divide their domestic market, to push through a 5 to 6 percent price rise to their major customers, the first increase in about two years. Prices to small steel distributors, however, remain stable. (C)

### EC Problems With the United States

The preliminary US decision to impose countervailing duties and the dumping charges filed by US producers have come at a critical time for the EC steel industry. After years of heavy losses—and similarly heavy government financial support to keep steel companies afloat—25-percent price increases in the past year under EC Commission guidelines have brought the industry near the break-even point. Success is creating its own problems, however; high EC prices are attracting imports and creating buyer resistance. The European view the partial closing of the US market, which took about 6 percent of EC steel production last year, as jeopardizing the European steel industry's long struggle to pull itself out of the red. This accounts in part for the angry European reaction to

### Employment in the OECD Steel Industries

*Thousand Persons*

	1970	1974	1978	1982 <sup>a</sup>
<b>Total</b>	<b>2,181</b>	<b>2,086</b>	<b>1,875</b>	<b>1,500</b>
United States	531	512	449	300
EC	900	792	699	545
Japan	462	454	423	370
Other OECD	288	328	304	285

<sup>a</sup> Estimated midyear.

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the US actions and for the threats of retaliation against US exports of textiles, petrochemicals, and agricultural products. The Economic Community already has filed a complaint with the GATT challenging the US action. (C)

### Growing Trouble for Steel Workers

Steel industry employment is dropping steadily. In the United States, only about 300,000 workers are currently on the job, compared with some 400,000 at midyear 1981. Job losses over the past year have been much less severe in other countries; employment declined only about 20,000 in the European Community during the same period and somewhat less in Japan. As EC and Japanese production slackens later in the year, however, more workers probably will be laid off. Throughout the OECD about 600,000 steel industry jobs have been lost since 1974. (C)

The dismal employment situation is finally beginning to cut steel worker wage gains. UK steel workers received wage increases of only about 4 percent in 1981 compared with an annual average of 18 percent during the previous six years. The 4.2-percent increase given to West German steel

**OECD:**  
**Projected Rolled Steel Market in 1985**

*Million Tons*

	1974	1979	1982 <sup>a</sup>	1985	Average Annual 1983-85 Economic Growth Rates		
					3.0 Percent	4.0 Percent	5.0 Percent
<b>Total</b>	<b>355</b>	<b>340</b>	<b>290</b>	<b>335</b>	<b>350</b>	<b>365</b>	
Domestic consumption	315	300	250	295	305	315	
Net exports	40	40	40	40	45	50	
Capacity utilization (percent)	89	79	68	75	79	82	

<sup>a</sup> Projected.

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workers this year will almost certainly mean a real wage cut. In Japan, the steel companies granted a 6.4-percent wage increase this spring, in contrast to the 6.8 percent achieved by most workers. In the United States, steel union leadership is cautiously giving in to the industry's demand that contract talks begin now even though the current agreement does not expire until August 1983. (C)

### Medium-Term Outlook

The medium-term outlook for the OECD steel-makers remains poor because:

- Economic activity continues to shift toward services and high-technology industries with low steel requirements.
- High energy costs are still reducing the steel content of passenger cars and suppressing many steel intensive investments in the energy sector.
- Economic growth probably will remain sluggish. Given these factors, we expect that OECD steel consumption at the top of the coming economic

recovery will be little or no higher than in 1973-74. Thus the steel market in the developed countries will have passed through an entire decade and two business cycles with virtually no growth. (C)

The export outlook appears little better. OECD exports have been flat since the mid-1970s as Third World countries have increased their self-sufficiency and imports by the Communist countries have been limited by hard currency constraints. The LDCs will expand their steel output further during the 1980s. The USSR will provide the largest export market over the next several years, although continuing hard currency constraints will limit its growth. (C)

The Soviets need Western steel because their own steel production problems are increasing the gap between domestic production and the steel needs prescribed by the 1981-85 economic plan. Since the Soviet market will offer EC and Japanese exporters one of their few opportunities for large sales, they can be expected to compete vigorously for new

business. The USSR now accounts for about 10 percent of OECD exports to third countries, and the share probably will grow slightly in the years ahead. (C)

Given this outlook, the OECD steel producers will still have massive excess capacity even at the peak of the coming business cycle. Rolled steel capacity in the OECD has increased about 20 percent since 1973-74, to nearly 445 million tons. It probably will remain at this level for a few years because rising yields of rolled steel from crude will offset the gradual decline in crude capacity. Since we do not expect total demand to be much, if any, higher than in 1973-74, capacity utilization is likely to remain close to 80 percent—not quite sufficient to put the weaker OECD steel industries back on their feet. In the steel market boom of 1973-74, the OECD industries operated at about 90 percent of capacity. (U)

#### Implications for the United States

The American steel industry will continue to face keen import competition for some years. Persistent excess capacity will have its heaviest impact on the export market, where competition is most severe. The US industry cannot compete with steel that is often sold on the world market below full cost of production—though rarely below variable cost. This “margin pricing” will continue as long as competition on the export market remains intense. (C)

Steel problems will be most acute with the European Community. Since EC domestic steel prices probably will remain well above world market levels, the Europeans will be vulnerable to dumping charges and a likely target for US industry complaints. EC steel exports to the USSR will remain another touchy issue. Exports of large diameter pipe, of particular importance to the Siberia-to-Europe gas line, and specialty steels that are important to Soviet defense will present the most difficult problems because of the importance of these exports to several major European firms. (C)

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